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No. 701

In the Supreme Court of the United States

OCTOBER TERM, 1958

GENE CLUCK AND VIVIAN CLUCK, PETITIONERS,

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

J. LEE RANKIN,
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QUESTION PRESENTED

Whether taxpayer's loss from the sale of his breeding herd was includible in the computation of his net operating loss in 1952 for the purposes of a carryback loss to 1951.

STATUTE INVOLVED

The relevant portions of Sections 23(s) and 122(a), (b) and (d) of the Internal Revenue Code of 1939 are set forth in the Appendix, *infra*, pp 8-9.

STATEMENT

Taxpayer[1] has been engaged in the farming and ranching business since about 1934 and has regularly bought, fattened and sold cattle. He usually keeps such cattle for from six months to a year and then sells them on the market to packers. He calls this his "commercial cattle business." (R. 13-14.)

Taxpayer, who had not had any breeding cattle for a number of years, decided early in 1951 to acquire a herd of such cattle and purchased, as a breeding herd, 288 cows and 10 bulls at a total cost of $63,638.51. All but 15 of the cows and 6 of the bulls were purchased on or before March 1, 1951. The last purchases were 14 cows and 6 bulls on December 1, 1951. (R. 14.)

On February 16, 1952, a veterinarian, after testing the taxpayer's herd of breeding cattle, advised taxpayer

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[1] For convenience, Gene Cluck will be referred to as the taxpayer, although his wife, Vivian Cluck, is also a petitioner inasmuch as she signed joint income tax returns with her husband for the years 1951 and 1952.

that some of the cows in the herd had Bang's disease which incapacitates cows as breeding animals by causing them to abort and to have premature calves. The taxpayer, upon being so advised, decided to discontinue his breeding operation, to fatten the breeding cattle and to sell them for beef as soon as possible. He sold 250 of them in 1952, 6 died in that year, and he sold the remaining 42 in 1953. He has had no intention to replace and he has not replaced his breeding herd. (R. 14.)

The Commissioner's statutory notice of deficiency treated the taxpayer's loss on the sale of the breeding herd as a Section 117-j loss and disallowed taxpayer's claimed loss on the sale of his breeding herd as a net operating loss for 1952 available as a carryback loss deduction in 1951. The Tax Court in upholding the Commissioner on this issue found that the loss of $15,776.13 sustained in 1952 from the sale of 250 cattle was not incurred in the operation of a trade or business regularly carried on by the taxpayer, within the meaning of Section 122(b)(1)(B) as limited by Section 122(d)(5) of the Internal Revenue Code of 1939. (R. 10, 16-20.) The Court of Appeals affirmed. (Pet. 13-14.)

ARGUMENT

This case presents a factual question of no general importance which has been decided adversely to the taxpayer by both courts below upon evidence which fully supports the result. Neither a conflict of decisions nor any other basis for further review exists.

1. The taxpayer here contends (Pet. 6-12), as he did in the Tax Court and in the court below, that the breeding animals were changed into a part of his commercial herd activity when he decided to fatten them and sell them. There is no merit to this contention which, as the Tax Court found (R. 19-20), is in conflict with taxpayer's testimony as well as his returns and books of account.

Taxpayer purchased the breeding herd for the purpose of breeding and raising cattle, segregated the breeding animals, and held them distinct from the commercial cattle in which he traded. The schedules attached to the stipulation of facts show that taxpayer kept his records as to the breeding herd separate from those relating to the cattle in his commercial herd. (Stip., R. 34-36, 43.) For example, in reporting the loss from the sale of 250 animals on his income tax return for 1952, taxpayer showed that loss of $15,776.13 separate and apart from the "Cattle Sales—Commercial" and labeled the transaction "Cattle Sales—Breeding." and "Gross Loss—Breeding Sales." (Ex. B. to Stip., R. 15, 37, 43.) Moreover, that return, as well as Schedule 1 attached to the Stipulation of Facts (R. 34-36, 43), show that taxpayer claimed full depreciation on these 250 cattle up to the date of sale—indicative of an intention to treat them as breeding cattle until the time of sale. Indeed, taxpayer testified that when the cattle in question were sold he considered that he was liquidating his breeding herd. (R. 39-41.) In fact, there is no affirmative act shown in the record which would serve to evidence conversion of the breeding herd into part of taxpayer's commercial herd, or to show that he placed his breeding herd with

the commercial cattle. Moreover, the schedules attached to the stipulation of facts indicate that the herd actually was used for breeding purposes during both 1951 and 1952, since there was a calf crop of 76 animals in 1951 and 185 in 1952. (See Stip. Schedules 2 and 3, R. 36, 43.)

The cases interpreting Section 122(d)(5) (Appendix, *infra*, p. 9), make clear that for a loss to be attributable to the operation of a trade or business, the loss must be incurred in the normal day to day operation of the enterprise (*Appleby* v. *United States*, 116 F. Supp. 410, 414 (C. Cls.)), and that a loss from the cessation of a business does not come within the net operating loss provisions. *Pettit* v. *Commissioner*, 175 F. 2d 195 (C.A. 5th); *Bratton* v. *United States*, 230 F. 2d 952 (C.A. 6th); *Smith* v. *United States*, 180 F. 2d 357 (C.A. 6th); *Baruch* v. *Commissioner*, 178 F. 2d 402 (C.A. 2d); *Lazier* v. *Commissioner*, 170 F. 2d 521 (C.A. 8th).

Furthermore, the mere fact that the assets which the taxpayer here sold and upon which he took depreciation were of the same *general* class of property as that in which he dealt in his commercial cattle business did not convert the sale of the assets used in the breeding business into a sale in the normal course of the commercial cattle business. Where, as here, the facts show that breeding herd animals continue to be held as such the cases are clear that any gain from their sale is not to be treated as gain from property held for sale to customers in the ordinary course of trade or business. See *Carter* v. *Commissioner*, 257 F. 2d 595 (C.A. 5th);[2] *O'Neill* v. *United States*, 211 F. 2d 701 (C.A.

[2] The opinion of the Court of Appeals inadvertently gives the citation for *Carter* v. *United States* as 255 F. 2d 595. (Pet. 13.)

9th), affirming *per curiam* (S.D. Calif.) (44 A.F.T.R. 931); *Albright* v. *United States*, 173 F. 2d 339; *Flato* v. *Commissioner*, 14 T.C. 1241, affirmed on other grounds, 195 F. 2d 580 (C.A. 5th); and *Fawn Lake Ranch Co.* v. *Commissioner*, 12 T.C. 1139. Similiarly, a loss on the sale of a breeding herd would not be a loss from the disposition of property held primarily for sale to customers in their ordinary course of trade or business. See *Puente* v. *Commissioner*, 199 F. 2d 940 (C.A. 9th), where it was held that a loss on a foreclosure sale of a dairy herd was not a loss sustained in business operations which could be carried back to the two preceding taxable years.

2. There is no conflict of decisions. Contrary to the taxpayer's assertion (Pet. 9), the decisions below are fully in accord with *Dalton* v. *Bowers*, 287 U.S. 404. There this Court held that the worthlessness of the stock of a wholly owned corporation was not a loss attributable to the operation of a trade or business regularly carried on by the taxpayer. In *Snyder* v. *Commissioner*, 295 U.S. 134, this Court held that, under the facts in that case, there was no substantial evidence that the taxpayer's activities in the stock market constituted a trade or business. That case has no relevance here.

Nor is there any conflict, as taxpayer alleges (Pet. 11), with *Home Co.* v. *Commissioner*, 212 F. 2d 637 (C.A. 10th), or with *Dougherty* v. *Commissioner*, 216 F. 2d 110 (C.A. 6th). Both these cases involved sales of wartime rental housing units, built under Government restrictions during World War II, which were sold after the restrictions were removed. There the courts held that there was adequate support in the

record for the finding of the Tax Court that the property was held during the taxable years primarily for sale to customers in the ordinary course of the trade or business. While those cases indicate that the initial purpose of acquisition although relevant, is not necessarily conclusive as to the purpose for which properties were held during the year of sale, here there was no showing in the record that taxpayer's breeding herd was ever converted into part of the commercial herd. The cases are plainly distinguishable on their facts.

CONCLUSION

It is respectfully submitted that the petition for a writ of certiorari should be denied.

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MARCH 1959.

APPENDIX

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(s) [Added by Sec. 211(a) of the Revenue Act of 1939, c. 247, 53 Stat. 862] *Net Operating Loss Deduction.*—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

* * * * *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 122. [Added by Sec. 211(b) of the Revenue Act of 1939, *supra*]. NET OPERATING LOSS DEDUCTION.

(a) [As amended by Sec. 105(e) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Definition of Net Operating Loss*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) [As amended by Sec. 215(a) of the Revenue Act of 1950, c. 994, 64 Stat. 906] *Amount of Carry-Back and Carry-Over.*—

(1) *Net operating loss carry-back.*—

* * * * *

(B) *Loss for Taxable Year Beginning After 1949.*—If for any taxable year beginning after

December 31, 1949, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for the preceding taxable year.

* * * * *

(d) [As amended by Sec. 105(e)(3)(C) of the Revenue Act of 1942, *supra*] *Exceptions, Additions, and Limitations.*—The exceptions, additions, and limitations referred to in subsections (a), (b), and (c) shall be as follows:

* * * * *

(5) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall (in the case of a taxpayer other than a corporation) be allowed only to the extent of the amount of the gross income not derived from such trade or business. For the purposes of this paragraph deductions and gross income shall be computed with the exceptions, additions, and limitations specified in paragraphs (1) to (4) of this subsection.

* * * * *

(26 U.S.C. 1952 ed., Sec. 122.)

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